United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-1252

To be argued by
ANDREW C. HARTZELL, JR.

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 74-1252

AMERICAN AIRLINES, INC.,
Plaintiff-Appellant,

against

AERLINTE EIREANN TEORANTA,
Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF PLAINTIFF-APPELLANT

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Preliminary Statement

Since the early days of aviation, federal law has barred foreign-owned aircraft from the internal air commerce of the United States. By reserving such commerce exclusively to aircraft owned by United States citizens, Congress has sought to ensure the development of a strong, domestically-owned air fleet. The economic and national defense aspects of this policy, which are similar to the federal laws regulating shipping, are obvious.

The present dispute arises out of an agreement (the "Agreement"), which, had it been carried out, would clearly have flouted this federal policy. The Agreement was made in 1968 between the Irish International Airline ("AET"), which is wholly owned by the Irish government, and Trans Caribbean Airways, Inc. ("TCA"), a domestic carrier which in 1971 merged into plaintiff-appellant American Airlines, Inc. ("American"). The Agreement provided that two Irish-owned 747 air-

craft would be leased, on a seasonal basis during the wintertime, to TCA for use on its domestic routes to the Caribbean.

AET terminated the Agreement in September 1970, two months before the first aircraft was to have been leased for the first winter. It based its termination on two minor defaults of TCA. These were make-weight reasons; its real reason for terminating was because it knew the Agreement could not legally be performed due to the prohibition on the registration and use of foreign aircraft in this country. AET hoped, by claiming that TCA was in breach and by terminating, to recover more than $13 million in damages as if lawful performance would have been possible. Since terminating, AET has sought by a series of strategic moves to place itself in a position to collect such damages.

The present appeal arises out of the complications resulting from this effort. After AET terminated, it commenced an arbitration against TCA seeking a declaration that TCA had been in default and that AET had followed proper "procedure" in terminating. The arbitrators so held in an award delivered on January 17, 1973. (A 204-05)* In the meantime, TCA on March 8, 1971, had merged into American, which succeeded to TCA's obligations under the Agreement. (A 164)

The award did not deal with the question of whether AET was entitled to damages if TCA was in default. Under the peculiar arbitration clause of the Agreement, that question was excluded from arbitration and was left for separate determination in the courts. Once the arbitrators found that TCA was in default, therefore, American brought the present declaratory judgment action, asserting that, notwithstanding the defaults, AET was not entitled to these enormous damages because the Agreement could not have been lawfully performed.

The amended complaint was based essentially on three propositions:

First, it asserted that since the aircraft were foreign-owned, they could not have been lawfully registered and used by TCA

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* Page references are to the Joint Appendix.

in the United States. Thus the Agreement could not lawfully have been performed and AET is not entitled to damages.

Second, the amended complaint alleged that the "defaults" for which AET terminated were *de minimis*, were immediately corrected by TCA, and caused AET no damages. They were simply the excuse AET used to terminate once the legality of registration was questioned.

Third, the amended complaint alleged that damages sought by AET under Section 9.2 of the Agreement were penal and therefore unenforceable.

AET moved to dismiss the amended complaint, its principal argument being that "the award had necessarily determined" that the foreign aircraft could be registered and used in the United States—that is, the Agreement could have been performed. Judge Wyatt, treating the motion as one for summary judgment, accepted this and other factual and legal contentions of AET and granted the motion. American moved for reargument, but Judge Wyatt simply issued a one-sentence order granting reargument and simultaneously confirming his prior decision and opinion. This appeal is taken from the judgment granting AET's motion and from the order confirming that judgment on reargument.

Issues Presented

1. Did the District Court err in granting summary judgment on the first three claims by resolving material disputed facts against American and by misinterpreting both the arbitration award and the Agreement?

2. Did the District Court err in granting summary judgment on the first three claims by disregarding the fact that federal law prohibits registration and use of the foreign aircraft in the United States?

3. Did the District Court err in granting summary judgment on the fourth claim by resolving material disputed facts against American and by ignoring its allegation that the TCA defaults did not proximately cause AET damage?

4. Did the District Court err in granting summary judgment on the fifth claim by resolving material disputed facts against American, by misinterpreting the Agreement, and by ruling that a court could award penal damages in this action?

5. Did the District Court err and abuse its discretion by alternatively declining to entertain the declaratory judgment action?

Statutes Involved

The statutes and regulations involved in this action are Sections 101(13), 101(16), 501 and 1108 of the Federal Aviation Act of 1958, 49 U. S. C. §§ 1301(13), 1301(16), 1401 and 1508, and Sections 47.43(a) and 47.5(c) of the Federal Aviation Regulations, 14 C. F. R. §§ 47.43(a), 47.5(c). These statutes and regulations are set forth in an addendum hereto.

Statement of Facts

A. The Agreement

The Agreement provided that the Irish aircraft would be leased to TCA for use on its domestic routes during five winter seasons. AET planned to use the aircraft on its own international routes during the balance of each year. (A 4, 160)

The first aircraft was to have been leased to TCA upon delivery from the manufacturer, Boeing, about November 9, 1970. (A 102) The second aircraft, which Boeing was scheduled to deliver in the spring of 1971, was to have been used first by AET and then leased to TCA beginning with the winter 1971-72. (A 4, 66, 80) The Agreement included as Exhibit 1 a form of

seasonal lease and provided that TCA would sign this form of lease each season for each aircraft. Total rents under the Agreement, which AET now seeks as a windfall, aggregated about $13 million. (A 4, 160)

Section 9.1 of the Agreement specified various acts and omissions by TCA, any one of which would constitute a "default". If a "default" continued after notice from AET and after a "grace period", it would ripen into an "event of default". (A 19-21, 152) Section 9.2 of the Agreement, a separate section, described AET's "remedies" if an "event of default" occurred. (A 21-24) The "remedies" included AET's right to terminate and recover damages.

Section 13.7 of the Agreement contained an arbitration clause which provided that (A 28),

> *"Except as herein provided to the contrary in Section 9.2,* any dispute concerning the validity, interpretation or application of this agreement, or any amendments thereto, . . . shall be settled by arbitration in New York City in accordance with the rules and regulations of the American Arbitration Association." (Emphasis added.)

The "except" clause referred to the separate "remedies" section. (A 163) Both parties agreed from the outset that the "except" clause prohibited the arbitrators from dealing with the subject of AET's remedies. See *infra* at 9-10.

TCA entered into the Agreement for the obvious purpose of using the aircraft. The Agreement reflected this purpose by, among other things, providing that it would automatically terminate if the aircraft could not be used. Section 4.1 of the lease form provided that TCA would use its best efforts to "effect registration" under Section 501 of the Federal Aviation Act, 49 U. S. C. § 1401,* and to obtain and maintain a certificate of airworthiness for the aircraft. (A 32) Section 19.2 of the lease form provided that if, notwithstanding its best efforts and for reasons beyond its control, TCA was unable to effect registration, or to obtain a certificate of airworthiness, or if it was unable to

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* Only an aircraft so registered can be flown in United States domestic air commerce.

use the aircraft in its operations because of *any* law or regulation or because of the action of any federal agency, then the lease would automatically terminate and neither party would be liable to the other. (A 37-39) Section 6 of Letter Agreement No. 1, which was part of the Agreement, provided that if any of the events stipulated in Section 19.2 of the lease form occurred, and as a result the first lease was cancelled, and if both parties were unable despite best efforts to cure the condition, the Agreement itself would automatically terminate. (A 41)

B. Pre-Termination Events

Early in 1970 American and TCA announced plans to merge.* As potential successor in interest to TCA, American began to examine various aspects of TCA's operations. In the early summer of 1970 American became aware that the Agreement raised a serious registration problem under federal law. (A 164)

Section 1108 of the Federal Aviation Act, 49 U. S. C. § 1508, provides that "foreign civil aircraft" shall not operate on domestic routes. Section 501 of the Act, 49 U. S. C. § 1401, provides that an aircraft cannot be registered in the United States—and hence become a "domestic" aircraft—*unless it is owned by a United States citizen and registered by him in his own name.* Section 47.43 of the FAA regulations, 14 C. F. R. § 47.43, provides that the registration of an aircraft is invalid if the registrant is a United States citizen "but his interest in the aircraft was created by a transaction that was not entered into in good faith and was made to avoid . . . compliance with section 501 of the Federal Aviation Act . . . that prevents registration of an aircraft owned by a person who is not a citizen of the United States." These prohibitions and restrictions were the basis for the problem inherent in the Agreement: the aircraft in question were owned by a foreign airline, but TCA (and, after the merger, American) was expected to register the aircraft in its own name as owner in order to use them seasonally on its domestic routes.

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* Stockholder and governmental approvals were required, and thus the merger was not consummated until March 8, 1971.

American's Assistant General Counsel, Richard Lempert, looked into the matter after it had been called to his attention. He also checked the matter with Preston Gaddis, a lawyer in Oklahoma City who is an expert in aircraft registration matters.* (A 182) Lempert's opinion, confirmed orally by Gaddis, was that the aircraft could not be lawfully registered. (A 164) On July 17, 1970, Lempert wrote to TCA's General Counsel setting forth the problem and requesting a meeting with the attorneys for both TCA and AET to discuss it. (A 101-02, 164)

The meeting requested by Lempert on July 17 was not held until August 17. AET's attorneys were unable to explain how the aircraft could be lawfully registered and used in this country. (A 164) In addition, and on the same day, Gaddis mailed to American a long written opinion confirming his earlier oral advice that the aircraft could not be lawfully registered. (A 107, 182)

Against this background, American decided to ask the FAA for a formal opinion on registration. (A 164) This was done at American's request by Gaddis who, on August 21, 1970, hand delivered a letter request to the FAA General Counsel's office in Washington, D. C. (A 183)

The FAA's Oklahoma City office immediately advised AET of American's request. (A 145, 165) AET then wrote to American, complaining that American was interfering with the Agreement. (A 165, 181) In a reply letter on August 27, 1970, American's General Counsel, Gene Overbeck, told AET that if the aircraft could be lawfully registered American would in no way hinder performance of the Agreement by TCA or by American after the merger. (A 184) On September 2, 1970, one day after receiving Overbeck's letter, AET notified TCA that it was terminating the Agreement.

On November 3, 1970, the FAA General Counsel's office, in a letter signed by Oscar Shienbrood, Acting Associate General Counsel, issued an opinion letter in response to American's request of August 21. The letter stated that TCA would not own the aircraft under the Agreement, and hence they could not be registered in the United States. (A 6, 142-45, 165) In view

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* The FAA aircraft registry office is located in Oklahoma City.

of this conclusion, the letter stated that it was unnecessary to reach the question whether such a registration by TCA would be invalid under Section 47.43(a)(4) of the Regulations. (A 145)

C. Termination by AET

AET's termination notice to TCA did not mention the registration question. Instead, it based termination on two unrelated alleged defaults by TCA, both of which were *de minimis* in the context of the Agreement as a whole (A 67-68, 82, 165-67):

(1) TCA's delay in making an advance payment of $85,000.*

(2) TCA's failure to execute the first seasonal lease.**

Although AET's termination caught TCA by surprise, TCA immediately cabled AET that it would comply with the Agreement and immediately corrected the two alleged "defaults". The next day it tendered the $85,000 payment; two days later it executed and tendered the first seasonal lease. AET rejected both tenders and refused to withdraw its termination notice. (A 68, 82-83, 111, 166)

AET thereafter notified TCA that it intended to arbitrate the question of whether TCA had been in default, as well as the question—not mentioned in its termination notice—of whether TCA had failed to use best efforts to register the aircraft. (A 166)

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* TCA had already made three prior payments totalling $335,000. The delinquent payment had been overdue for more than a year, since July 1, 1969, and AET had let the matter ride because of TCA's financial straits pending the merger with American. There was no question of the payments ultimately being made (A 66-67, 80-81, 110-111), and in the meantime AET suffered no loss because it was obligated to pay TCA interest on the advance payment if it had been made (A 18).

** Since the first aircraft was not due until November 9, 1970, TCA believed the deadline for the first lease was September 9, 1970, or 60 days before delivery, as Section 2.4 of the Agreement in plain English provided. (A 17, 67, 80-81, 111)

As stated above, American had told AET that if the aircraft could be lawfully registered, American was prepared to assist TCA in taking the aircraft as required by the Agreement, and to do so itself after the merger. The application to register the first aircraft would not have been filed until November 9, 1970 when the aircraft was ready for delivery and when the Bill of Sale from Boeing to AET and other necessary documents would have been in hand. (A 105) In September 1970, therefore, even after AET's termination, American invited AET to meet jointly with TCA and the General Counsel of the FAA to see if the registration question could be speedily and definitely settled. AET refused to attend such a meeting, its counsel stating that since it had terminated the Agreement, the registration issue was "academic". (A 107-08) AET's counsel also advised the FAA, in response to an inquiry from the FAA itself, that AET did not wish to discuss the registration issue with the FAA. (A 113, 184)

D. TCA's Application to Stay the Arbitration

On October 15, 1970 AET served an amended Demand for Arbitration, and TCA moved for a stay.* (A 167) TCA argued that, although the arbitration clause applied to disputes under the on-going Agreement, it was not meant to apply when AET had terminated. (A 84-86, 167-68) It was undisputed that the subject of AET's remedies, if any, under Section 9.2 of the Agreement was excluded from arbitration. (A 168-70, 189-93, 197-202) After AET had terminated, therefore, it must have been intended that the entire dispute, including questions of both default *and* remedies, would be put to the courts in the first instance. Otherwise the arbitrators would be deciding default questions in a vacuum and the parties would still face a later court fight over remedies. Consistent with the contention that the matter should go to the courts, TCA included in its stay petition its own request for a declaratory judgment that AET had wrongfully terminated the Agreement, that TCA had no further obligation to AET, and that AET should return TCA's advance payments. (A 86, 168)

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* A motion to stay AET's original Demand for Arbitration, served September 23, 1970, was granted, without prejudice to refiling, because of a defect in form. (A 70, 167)

AET contended that the Agreement called for arbitration as to questions of "defaults", while excluding questions of AET's remedies if TCA were found in default. (A 168-70, 189-93, 197-202) Justice Leff in the state court accepted this distinction (A 90-91) and denied TCA's motion for a stay. (A 89-91) He also dismissed TCA's request for declaratory judgment, stating that the "claim is covered by the arbitration clause," and that in any event the court had "no jurisdiction over AET with respect to that portion of the petition seeking declaratory judgment in the absence of proper process." (A 91) Justice Leff's ruling was affirmed without opinion. 319 N. Y. S. 2d 982 (1st Dep't March 29, 1971), *leave to appeal denied*, 324 N. Y. S. 2d 1025 (Ct. App. June 9, 1971).

E. TCA's Answering Statement

After denial of its stay motion, TCA was required to file an answering statement in the arbitration. (A 110-14) TCA denied that it was in default and asserted that AET had terminated the Agreement in bad faith. It also pointed out that "the Federal Aviation Administration on November . . . [3], 1970 . . . ruled that the aircraft could not be . . . registered." (A 113) TCA therefore asserted that AET's claims as to default were "moot", and that TCA had no further obligations under the Agreement. (A 113)

In a counterclaim TCA asserted that because of AET's bad faith termination, and because the aircraft could not be registered in the United States, it was entitled to a declaration that it had no further obligations under the Agreement and that it should recover its advance payments. (A 113-14)

TCA's answering statement did not ask the arbitrators to second-guess the FAA which had already decided that the aircraft could not be registered. Rather, TCA asserted that because the aircraft could not be lawfully registered, it followed that (1) AET's claims were "moot", and (2) TCA was entitled to its own declaration of no liability and to a refund of its advance payments.

AET itself recognized that the arbitration did not require the arbitrators to decide on the legality of registration. (A 253-54)

Thus, in its pre-hearing memorandum to the arbitrators, filed after TCA had served its answering statement, AET stated (A 253),

> "The issue raised by Irish's demand for arbitration is whether TCA was in default at the time Irish terminated the Agreement. . . . If the Agreement was thus properly terminated, there can be no issue as to registrability of the aircraft."

F. The Arbitration

The arbitration hearings commenced in December 1971. TCA introduced the FAA opinion on registration, together with other evidence, to explain the nature of the registration problem and how it had arisen and had been handled in the summer of 1970. This was not done to relitigate the question itself but to show the arbitrators that TCA had not been in violation of any "best efforts" obligation to register the aircraft when AET terminated, and that AET's termination was not motivated by TCA's alleged defaults but was a stratagem to bring the Agreement to an end in the hope that AET could thus position itself to collect damages under Section 9.2 in a later court action, even though the aircraft could not lawfully have been registered and used by TCA. (A 176-77)

On January 17, 1973, the arbitrators issued an award, dated January 3. (A 204-05) The award is a sketchy document, limited to a few particular issues. It states that, as of September 2, 1970, there was an "Event of Default" by TCA on the grounds of:

> (1) failure to make the advance payment of $85,000;
>
> (2) failure to execute the lease for the initial period;
>
> (3) failure to use best efforts to register the aircraft; and
>
> (4) AET "followed proper *procedure* in effectuation of cancellation". (Emphasis added.)

The award also denied, without comment, TCA's request for declaratory relief, stating merely that "RESPONDENT's counter-

claim is dismissed." (A 205) It concluded with the boilerplate language that it was "in full settlement of all claims and counterclaims submitted to this Arbitration."

The award does not state that the aircraft could, or could not, have been lawfully registered. (A 204-05, 172)

G. The Present Action

The first three claims in the present action are based upon the contention that the foreign-owned aircraft could not have been lawfully registered. Therefore, the Agreement could not have been lawfully performed, and AET cannot be awarded windfall damages. (A 3-10)

The fourth claim alleges that AET had no substantive right to terminate the Agreement, and also asserts that TCA's defaults did not cause AET's damages.

The fifth claim alleges that the remedies provided for by the Agreement are penal and therefore cannot be enforced regardless of TCA's defaults.

H. The Decision of the District Court

The District Court treated AET's motion to dismiss "as one for summary judgment. . . ." (A 256) It then violated the cardinal rule for summary judgment motions by resolving numerous disputed facts and conflicting inferences against American.* These disputed matters fell into two categories. First, the District Court leaped to a series of rash conclusions against American which plainly colored its decision. For example, the District Court concluded that:

> (1) "The Shienbrood letter was not 'a formal opinion' . . . was not 'issued by the FAA' . . . and does not state that 'the aircraft were not registrable'." American's

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* It did this despite the fact that the motion papers bristled with disputed facts and arguments. In addition, AET never filed a statement of undisputed facts as required by the District Court's General Rule 9(g). American protested this failure but to no avail. (A 174)

characterization of the letter as an FAA opinion was described as "a gross exaggeration". (A 261)

(2) The "circumstances" of American's inquiry to the FAA were "highly questionable, to say the least" since registration questions "appear normally" to be dealt with in Oklahoma City and it "is not easy to understand" why Gaddis would go to Washington to see Shienbrood. (A 258-59)

Second, the District Court decided disputed facts which were fundamental to its analysis and built its legal conclusions on these "facts". For example, it concluded, on an incomplete record, that:

(1) The question of registrability was "specifically addressed to the arbitrators." (A 265)

(2) The award "necessarily decided the [registration] point against plaintiff." (A 265)

In this manner, it proceeded summarily to dismiss all five claims in the amended complaint.

It dismissed the first three claims on the ground that the registration issue "had been specifically addressed to the arbitrators and the award necessarily decided" the point against plaintiff. (A 265) It further held, in part "C" of the opinion (A 266-67), that under the Agreement TCA was contractually precluded from questioning the legality of registration.

It dismissed the fourth claim on the ground that the arbitrators had decided that AET had the substantive right to terminate the Agreement. (A 265) The Court overlooked the allegation in the fourth claim that TCA's defaults did not proximately cause any damage to AET; hence the opinion fails to deal with this allegation.

It dismissed the fifth claim, which alleged that the remedies sought by AET under Section 9.2 of the Agreement were penal, on the ground that TCA had warranted that the remedies were not penal. (A 266)

Finally, the court held that "even if TCA had some claim on the merits," the court would decline jurisdiction in the exercise of discretion. (A 267-68)

I. American's Motion for Reargument

In its motion for reargument, American pointed out to the District Court that it had improperly resolved numerous disputed issues of fact in granting AET's motion. To counter the critical attitude which the Court had adopted toward American, based on the Court's accepting as "facts" the arguments of AET's counsel, American particularly pointed out the following:*

1. The opinion issued in Washington, although in the form of a letter signed by Shienbrood, was as formal an FAA opinion as is available. (A 278-79) In the arbitration itself affidavits were submitted from Shienbrood and from Woodruff, one of the two FAA lawyers in the Oklahoma City Center Counsel's office. Shienbrood's affidavit stated (A 278):

> (a) The letter which he signed was a "formal opinion letter" issued on behalf of the FAA itself.
>
> (b) "[T]he FAA concluded" in the opinion letter "that the aircraft referred to in the letter could not be registered by TCA in the United States."
>
> (c) The "FAA opinion as formally rendered" was "based on its [the FAA's] own analysis of the agreement between the parties and on the applicable law and regulations as interpreted and administered by the FAA," and not upon "the views" of the interested parties.

Woodruff's affidavit stated (A 278-79):

> "After American's request was submitted to the FAA, and while the General Counsel's Office was considering its response to the request, Messrs. Shienbrood and Krassa consulted with our office and obtained our views with respect to the issues involved. Thereafter, on November 3, 1970, the FAA in Washington issued its opinion letter that the AET aircraft could not be registered in the United States."

2. The "circumstances" of American's request to the FAA were not "questionable" at all. Gaddis went to the General Counsel's office in Washington because that office was the authoritative place to get such an opinion. It was superior to the Okla-

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* We do not suggest that the District Court had to accept American's version of these facts, but only that it should not have accepted AET's version.

homa City office, which had only two young lawyers who were subordinate to the General Counsel's office and whose opinion, even if obtained, would have to be reviewed by the General Counsel's office. (A 275) There was simply no point, under the time pressures that existed by late August, to start in Oklahoma City. Gaddis went specifically to Shienbrood because Woodruff gave Gaddis Shienbrood's name as the appropriate FAA official to contact. (A 275-76) Neither Gaddis nor American attempted to exclude the Oklahoma City office from participating in the reply, as the District Court opinion suggests; on the contrary, a copy of American's request for an opinion was hand delivered to the FAA's Oklahoma City office at the same time the original was delivered to Washington so that both offices could confer on the question. (A 276-77) They in fact did so before the opinion was issued by Washington. (A 278-79)

3. The registration issue arose so sharply in June 1970 because Eastern Airlines was interested in subleasing the Irish aircraft but raised with American the question of whether such a foreign-owned aircraft could be registered and used in the United States. (A 272) Without telling American, Eastern's Senior Vice President for Legal Affairs, Glen Harlan, put the same question to Eastern's outside general counsel, the Atlanta law firm of Gambrell, Russell, Maze & Killorin. On June 23, 1970, the Gambrell firm sent Harlan a letter stating that the AET aircraft could not be lawfully used in the United States. The opinion concluded with the following language (A 272):

> "We have no explanation for the Trans Caribbean-Aerlinte lease. Neither we nor anyone on the CAB's staff could suggest how the airplane might be used lawfully by Trans Caribbean."

After getting this opinion from his own outside counsel, Harlan repeatedly prodded American to get the registration issue resolved. In fact a Harlan call to American on August 17, 1970, asking that American get the question resolved, was one of the factors which led to Gaddis going to the FAA on August 21, 1970. (A 273-75)

These and other facts demonstrating the District Court's mistaken conception of events were pointed out in American's reargument memoranda. (A 270-86, 319-20)

American also pointed out that the Court's opinion completely neglected to deal with the fact that federal statutory law and public policy prohibit the registration of the AET aircraft in the United States, and that a federal court could not award damages in the present case as if the aircraft could have been registered here without violating this policy. (A 284-88) AET in opposing reargument could not dispute that the District Court had ignored this question, and recognizing its importance, was forced to suggest that the Court on reargument should state that it had considered "plaintiff's 'public policy argument'," which of course AET urged it to reject. (A 308) Despite the request from both parties that the matter be considered, the District Court continued to ignore it. On January 10, 1974 it entered a one-sentence order granting reargument but approving and confirming its original decision and opinion without substantive comment. (A 326)

Argument

I.

The District Court erred in granting summary judgment on the first three claims by resolving material disputed facts against American and by misinterpreting the arbitration award and Agreement.

It is well settled that summary judgment cannot be granted if there is a genuine issue as to any material fact and that, for purposes of making that determination, the moving papers must be viewed in the light most favorable to the party opposing the motion. *Adickes* v. *Kress & Co.*, 398 U. S. 144, 157 (1970). Furthermore, the factual assertions by affidavit and other evidentiary material submitted by the party opposing the motion must be taken as true in ruling on the motion. *First National Bank of Cincinnati* v. *Pepper*, 454 F. 2d 626, 629 (2d Cir. 1972). Here, the District Court did exactly the opposite. It first decided against American numerous disputed peripheral facts as to the relative merits of the parties' conduct in 1970; then, based on its own interpretation of "the history of the dispute and of the arbitration" (A 265), the court concluded that:

> (A) the question whether the aircraft could be lawfully registered "was specifically addressed to the arbitrators" (A 265);

(B) the award "necessarily decided the point against" American (A 265); and

(C) in any event, American was precluded by the terms of the Agreement from arguing that the aircraft could not have been lawfully registered (A 266-67).

Each of these points is based on the District Court's impermissible resolution of disputed facts. Furthermore, even if it had been permissible to decide such facts, each point is analytically erroneous.

A. The Registration Issue Was Not Submitted to Arbitration

Both parties introduced evidence at the arbitration to explain what the registration issue was all about, and to put in context the parties' conduct in dealing with the subject in the summer of 1970. This evidence was not submitted to have the arbitrators rule on registration per se, but because AET claimed that TCA had failed to use "best efforts" to obtain registration.* When the District Court, on an incomplete record made up of argumentative affidavits from AET's counsel and extracts from arbitration briefs, determined that the registration issue per se was submitted to the arbitrators for decision, it resolved disputed issues of fact which is impermissible on a motion for summary judgment.

The District Court had the role of an appellate court called upon to decide what issues had been submitted at the trial level. This necessarily required a review of the full trial record. But it did not have the full record. It merely had argumentative statements from the opposing lawyers, and extracts from briefs in the arbitration, all of which were contradictory as to the purposes for which evidence and arguments relating to registration were made. See *Ungar* v. *Mandell*, 471 F. 2d 1163, 1166 (2d Cir. 1972) (excerpts from the state court record insufficient to determine "whether the existence of the alleged agreement was litigated and was essential to [the state court's] final adjudication.")

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* Although the registration statute and regulations were discussed in the arbitration, the full policy background and purposes were not developed in depth because the issue as such was not submitted for decision in the arbitration.

It is but common sense to recognize that American had no reason to ask the arbitrators to rule on the legality of registration. As far as American was concerned, the FAA had ruled in Shienbrood's letter of November 1970 that the aircraft could not be registered. This was more than a year before the arbitration hearings began. It is unreasonable to suppose that American was asking the arbitrators to second-guess the FAA, which was not only the federal agency primarily charged with administering the registration statute but the agency whose opinion letter confirmed American's own view of the matter. See also *supra* at 10-11, 14.

Furthermore, even if the issue had been *presented*, that does not establish it was *decided*. See, *e.g.*, *Feinstein* v. *Carl-Dress Corp.*, 156 N. Y. S. 2d 636, 638 (Sup. Ct. Westchester Co. 1956) (that testimony "was 'offered' . . . at the hearings before the arbitrator is not a showing of the litigation or consideration of such controversies and matters by the arbitrator"); *Kittinger* v. *Churchill*, 161 Misc. 3, 13, 292 N. Y. Supp. 35, 45 (Sup. Ct. Erie Co.), *aff'd*, 249 App. Div. 703, 292 N. Y. Supp. 51 (4th Dept. 1936).

B. The Award Did not "Necessarily" Decide the Point Against American

The District Court did not explain its summary conclusion that the "award necessarily decided the [registration] point against" American. It may simply have based its conclusion on the impermissible assumptions referred to above. From its recitation of the "facts", however, and from AET's arguments to the District Court, the conclusion may have been based on (1) the arbitrator's ruling that as of September 2, 1970 TCA had failed to use best efforts to register the aircraft; or (2) the arbitrators' rejection of TCA's "mootness" defense; or (3) the arbitrators' dismissal of TCA's counterclaim.

(1) **The "Best Efforts" Ruling.** As previously stated, the application for registration would not have been submitted to the FAA until the aircraft was received from Boeing in November 1970. (A 105) The arbitrators' ruling that TCA had not exer-

cised "best efforts" as of September 2, 1970 does not provide any basis for concluding one way or the other that they decided on the legality of registration.*

(2) **The Mootness Defense.** TCA's Answering Statement in the arbitration asserted that "(a)" because the aircraft could not be lawfully registered, "(b)" it followed that AET's claims as to default were moot. Since the arbitrators decided that TCA was in default, they necessarily rejected "(b)" as a valid defense in the arbitration. But that does not prove that they rejected "(a)". They may have concluded that "(b)" did not follow from "(a)", regardless of the correctness of "(a)". Or they may have decided that "(b)" related to remedies, a subject outside their province. Since the award is totally silent as to "(a)", and consistent with a ruling either way on "(a)"—or, indeed, with no ruling at all—no one can say that the award necessarily decided "(a)" or decided it in a particular way.**

Whether American is barred from litigating the registration issue in the present case depends on the doctrine of collateral estoppel, not res judicata. Res judicata applies only when there is an attempt to retry the same "claim" twice. *Lawlor* v. *National Screen Service Corp.*, 349 U. S. 322, 326 (1955); *Adley Express Co.* v. *Highway Truck Drivers and Helpers, Local No. 107*, 349 F. Supp. 436, 445 (E. D. Pa. 1972). In the arbitration the "claim" was that TCA was in default. In the present case the

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* Even if the award had expressly held that the aircraft could have been lawfully registered, that holding would not have been "necessary" to the finding that TCA had failed to use best efforts as of September 2; under the doctrine of collateral estoppel, discussed in the following paragraphs, such a holding would not be a bar to American claiming in this action that registration would have been illegal.

** An example will illustrate the point. Suppose TCA had argued in the arbitration that "(a)" because the IRA is committing acts of sabotage, "(b)" all AET flights to New York should be prohibited. The denial of the relief sought in "(b)" would not, of course, constitute a finding that the IRA was—or was not—committing acts of sabotage.

"claim" is that AET is not entitled to any remedies, TCA having been found in default.*

Under the doctrine of collateral estoppel, AET must prove that the award "actually" and "necessarily" determined the registration issue, and that such a determination was "essential" to the award. See *Lynne Carol Fashions, Inc.* v. *Cranston Print Works Co.*, 453 F. 2d 1177 (3d Cir. 1972); *Adley Express Co.* v. *Highway Truck Drivers and Helpers, Local No. 107, supra; Sweetheart Plastics, Inc.* v. *Illinois Tool Works, Inc.*, 439 F. 2d 871, 873 (1st Cir. 1971); 1B Moore, *Federal Practice* ¶0.443[1] (1965). As shown above, it is not logically possible to do so.

Lynne Carol Fashions is in point. There, a fabric purchaser sued the manufacturer claiming the fabric was defective. In a prior arbitration between the purchaser and the fabric converter who had sold him the fabric, the arbitrators held that the converter was entitled to the purchase price despite the purchaser's defense that the fabric was defective. The purchaser's counterclaim for lost profits and other damages was also "denied in its entirety". No reasons were stated in the award. In the subsequent court action, the manufacturer argued that the purchaser was collaterally estopped from re-litigating the question of the quality of the fabric. The court rejected the argument. First, it felt that the precise issue was not presented, at least in the same context, in the arbitration. Second, even if presented, since the award did not state any reasons, no one could tell whether the issue actually had been decided or whether a decision on the issue was "necessary" to the award:

> "The requirement that the issue to be barred must have been necessary to the decision in the first litigation is well entrenched in the law. . . . Here, because of the contractual defense raised by [the converter in the arbitration], it is possible that the arbitrators could have found that the goods *were* defective, but that recovery was not war-

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* Normally the word "claim" would embody both the question of default and the question of remedy, since courts do not ordinarily deal with half-claims. The arbitration clause, however, as interpreted by Justice Leff and as permitted by CPLR 7501 (A 90-91), actually split the claim in half, leaving only the first part, relating to defaults, to be determined in the arbitration. We use the word "claim" in that sense in the discussion above.

> ranted because [the purchaser] had not complied with the contractual terms. However, the arbitrators' decision merely announced the award, but is silent as to the specific grounds relied on. Thus it is impossible to determine from the arbitration whether the goods were in fact found to be defective." 453 F. 2d at 1183.

Similarly, in *Adley Express Company* v. *Highway Truck Drivers and Helpers, Local No. 107*, 349 F. Supp. 436, 444-45 (E. D. Pa. 1972), a union had been enjoined from several forms of strike conduct as well as from violating generally its contract with management. Subsequently, the union was found in contempt for having violated the injunction, but the court did not state specifically in which respects the injunction had been violated. In a second action by management against the union for damages for breach of its contract, management argued that the union was collaterally estopped from asserting that it was not in breach of its contract since the prior contempt finding constituted a finding of such a breach. The court ruled that although the issue of the union's contractual breach "was material and relevant" to the contempt proceedings and "was raised and litigated", it could not be said that the issue was actually and necessarily decided, since the contempt ruling did not contain specific factual findings on the point and could have been based on violations of other portions of the injunction and not specifically on the portion prohibiting breach of contract.

It is similarly impossible in the case at bar to determine from the arbitrators' rejection of the mootness defense whether they decided the registration issue one way or the other or, if they did, whether such a decision was necessary to their rejection of "mootness" as a defense to AET's request for a finding that TCA was in default.

(3) **Dismissal of TCA's Counterclaim.** The same reasoning and authorities apply to the dismissal of TCA's counterclaim. The counterclaim asserted that "(a)" because the aircraft could not be lawfully registered, "(b)" it followed that TCA was entitled to a declaration of no liability and to the refund of its advance payments. The award did no more than dismiss the counterclaim. It is thus impossible to say that the arbitrators decided "(a)" one way or the other, or even that they regarded it as an issue for decision.

In addition, the "mere dismissal" of a claim for declaratory relief—and TCA's counterclaim in the arbitration was one for declaratory relief—is "not an affirmative declaration of the parties' rights." *Medical World Publishing Co.* v. *Kaufman*, 29 App. Div. 2d 859, 288 N. Y. S. 2d 548 (1st Dep't 1968). See also *Sachs* v. *Real Estate Capital Corp.*, 31 App. Div. 2d 916, 298 N. Y. S. 2d 456 (1st Dep't 1969); Siegel, *Practice Commentaries: CPLR 3001*, 7B McKinney's Consolidated Laws of New York 354, at 372 (1974). In the exercise of discretion, such a claim can be dismissed without reaching the merits at all; it is impossible to tell from a mere dismissal, what the basis was. For this reason "the doctrines of res judicata and collateral estoppel have no application" when a court or arbitrator, without more, dismisses a request for declaratory relief. 3 Weinstein, Korn & Miller, *New York Civil Practice* ¶3001.20, at 30-110/11 (1972).*

This reasoning is especially appropriate here, if one looks back at the state court proceedings prior to the arbitration. When TCA moved in the state court to stay arbitration, it asked for a declaration that AET had wrongfully terminated the Agreement. This was consistent with TCA's contention that no part of the dispute was arbitrable and that the court therefore should declare *TCA's* remedies against AET. Justice Leff disagreed with TCA's contention, holding that questions as to TCA's defaults were arbitrable, even though questions relating to AET's remedies (in the event of default) were not. After this primary ruling, he dismissed TCA's request for declaratory relief for lack of proper service, adding that the request was for the arbitrators. By this Justice Leff must have meant that if the arbitrators found that TCA was *not* in default, then they could decide the additional issue of whether TCA was entitled to a declaration of no liability, since *TCA's remedies, as distinguished from AET's remedies under Section 9.2*, were not excluded from arbitration. On the

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* New York's declaratory judgment provision, CPLR 3001, in apparent recognition of the limbo in which issues are left when a claim for declaratory judgment is dismissed without more, provides that "if the court declines to render such a judgment it shall state its grounds." The arbitrators did not do so.

other hand, if TCA *were* in default, then the question of AET's Section 9.2 remedies arose, and that question was beyond the scope of the arbitration. In the latter circumstances, which are the circumstances of the present case, the arbitrators could not decide TCA's request for declaratory relief without impinging on the question of AET's Section 9.2 remedies. Their only available course of action under these circumstances was to dismiss TCA's counterclaim without deciding *any* of the issues with respect to remedies. That appears to be exactly what they did.

The award itself demonstrates that the arbitrators knew how to decide specific issues when they wanted to do so. AET sought from the arbitrators a declaration that TCA was in default in several particulars and that AET had followed proper "procedure" in terminating. In granting such relief, the arbitrators did not simply say, "We declare TCA was in default." Instead, their award stated the respects in which they found TCA to be in default and on what date. It would have been equally simple for the arbitrators to have been specific in denying TCA's request for declaratory relief if that denial was intended to constitute a ruling on particular issues.*

Finally, it should be noted that until *this* action was commenced, AET itself recognized—and took pains to remind the arbitrators—that it was not necessary for them to decide the registration issue in order to decide the arbitration. Thus in its pre-hearing memorandum to the arbitrators, AET observed that "there can be no issue [in this arbitration] as to the registrability of the aircraft." (A 253) Only after this lawsuit was commenced, and AET saw the expediency of contending that the arbitrators had decided the registration question, did AET adopt its present position. The District Court, summarily resolving every disputed fact and inference against American, erroneously accepted AET's belated contention.

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* The boilerplate language that the award is in full settlement of all "claims and counterclaims" adds nothing. It merely means that the arbitrators have discharged their functions, but does not explain by what reasoning they disposed of particular "claims and counterclaims".

C. The Agreement Does Not Bar American From Showing That The Aircraft Are Nonregistrable

The District Court, in part "C" of its opinion (A 266-67), dismissed the first three claims on a further ground. It stated that "TCA may not assert as against AET that the aircraft could not be lawfully registered" because (1) the Agreement provided certain "procedure for securing registration and the consequences if such procedure did not result in registration", and (2) the "procedure provided for securing registration was never followed because of the defaults of TCA." (A 266-67) Both these propositions are fallacious.

(1) **Registration "Procedure".** The Agreement provided that if the aircraft could not be registered despite best efforts, and as a result the aircraft were grounded, the Agreement would *automatically* come to an end. The District Court treated this provision for automatic termination as if it were a prohibition against TCA—and, for that matter, AET—challenging the legality of registration. This is a complete distortion of the Agreement. It did not state that it was necessary to go through the motions of trying to register the aircraft without success before one could challenge the legality of registration. The Agreement merely provided that under certain circumstances it would automatically terminate if registration was unsuccessful—no more and no less.

The District Court's construction is also wholly unreasonable. It is unlikely in the extreme that either party contracted to preclude itself from questioning the legality of registration unless both parties had unsuccessfully gone through with each step which would lead to automatic termination of the Agreement. If, after the Agreement was signed in February 1968, it became clear that these aircraft could not be registered or used, can it really be supposed that the parties were foreclosed from raising the issue until after the first aircraft was delivered in November 1970, and grounded for ten days? See Lease Form § 19.2. (A 38-39) Millions of dollars had to be commited in advance of delivery of the aircraft for spare parts, ground handling equipment, pilot and stewardess training, and other preparations. It is commercially absurd to construe the automatic termination provisions as prohibiting either party in advance from question-

ing whether the aircraft could be lawfully used by TCA in the United States.

Even if the Agreement were ambiguous on this point, the District Court should not have resolved such an ambiguity on a motion for summary judgment. It is well settled that if disputed inferences can be drawn from documents, summary judgment should be denied. *Empire Electronics Co.* v. *United States*, 311 F. 2d 175, 179-80 (2d Cir. 1962); *Lemelson* v. *Ideal Toy Corp.*, 408 F. 2d 860, 864 (2d Cir. 1969); *Painton & Co.* v. *Bourns, Inc.*, 442 F. 2d 216, 233 (2d Cir. 1971); 6 Moore, *Federal Practice* ¶56.17[11], at 2507 (1965).

(2) **Results of Default.** The District Court also erred in ruling that "the procedure provided for securing registration was never followed because of the defaults of TCA."

First, if the aircraft could not have been lawfully registered, the claimed TCA defaults are immaterial. It is hornbook law that a breach of contract is immaterial if the contract is impossible lawfully to perform.

United-Buckingham Freight Lines v. *Riss & Co.*, 241 F. Supp. 861 (D. Colo. 1965), is in point. There, the plaintiff sued to recover its down payments made under a contract for the purchase of the defendant's operating rights. The ICC had disapproved the purchase. The defendant claimed that the plaintiff had breached it best efforts obligation to secure ICC approval. The court held that even if the plaintiff had breached, it still was entitled to summary judgment because the failure to obtain the ICC approval resulted not from the plaintiff's breach but from a defect "integral to the agreement [which] could not be changed by any unilateral action of either party." *Id.* at 864. See also *Fratelli Pantanella, S.A.* v. *International Commercial Corp.*, 89 N. Y. S. 2d 736, 739 (Sup. Ct. N. Y. Co. 1949) ("since the contract was ultimately impossible of performance, repudiation of the contract does not found an action for breach of contract"); 15 Williston, *Contracts* § 1759, at 192-93 (3rd ed. 1972). As shown hereafter in more detail, see *infra* at 28-41, it would not have made any difference what

efforts were used by TCA; the aircraft could not have been lawfully registered in the United States.

Second, TCA's defaults were not the reason "the procedure provided for securing registration was never followed. . . ." This is dramatically demonstrated by reviewing the relevant events:

(1) September 2, 1970: AET terminated, asserting TCA's failure to sign the first seasonal lease and its failure to make the fourth advance payment of $85,000.

(2) September 3, 1970: Although disagreeing with AET's assertion that there were two defaults, TCA cabled AET that it was ready to meet its obligations under the Agreement and would immediately correct the alleged defaults.

(3) September 3, 1970: TCA delivered the $85,000 to AET.

(4) September 4, 1970: AET rejected the $85,000 payment and insisted on keeping the Agreement terminated.

(5) September 5, 1970: TCA mailed the executed seasonal lease to AET.

(6) September 8, 1970: AET rejected the executed seasonal lease.

(7) To the end of September: Despite the purported termination, operational preparations for TCA to receive the first aircraft in November continued. During this period American attempted to arrange a meeting of all parties with the General Counsel of the FAA to discuss and resolve the registration question. AET rejected the invitation and also rejected the FAA's solicitation of AET's views.

(8) September 23, 1970: AET commenced arbitration proceedings for a declaration that TCA was in default on September 2, 1970.

It is obvious that the two TCA defaults for which AET terminated did not "cause" the termination, or "cause" the Agreement to remain terminated. Nor, as the District Court found, was "the lease . . . never executed". On the contrary, the lease was executed and tendered on September 5.* The parties did not reach the stage of applying for registration in November because AET insisted on keeping the Agreement terminated. This was but the first step in its continuing effort to collect as a windfall all the rents even though (i) AET is the party which terminated, (ii) its aircraft were never delivered to TCA, and (iii) the aircraft could not have been lawfully registered and used. AET is trying to get something for nothing, to get by terminating what it could not get by performing.

The District Court, on a motion for summary judgment, could not resolve all facts and inferences against American and conclusively assert that TCA's minor defaults in unrelated matters operated as a barrier to normal registration procedures.

Putting aside the criticism of American's conduct which permeates the District Court's opinion, certain facts cannot be ignored. Neither TCA, nor American, terminated this Agreement. Neither of them, in the summer of 1970, brought a court action to have registration declared illegal. American merely raised the question of registration, emphasizing to AET that if the aircraft could be lawfully registered, both TCA, and after the merger American, would fully perform the Agreement. It is AET that has sought, from the moment that registration was questioned, to avoid having the issue examined and determined. How can AET be permitted to avoid the issue by its precipitous termination and then be allowed to sue for all the rents as if the aircraft could lawfully have been registered in the United States?

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* TCA and American always contended that this tender, made more than 60 days before delivery of the first aircraft, was timely under Section 2.4 of the Agreement. (See A 17) The arbitrators, stating no reasons, held otherwise.

II.

The District Court erred in granting summary judgment on the first three claims by disregarding the fact that federal law prohibits registration and use of the foreign aircraft in the United States.

The District Court completely ignored the contention that federal law and aviation policy bar U. S. registration and use of the aircraft.* By ignoring this contention, and then ruling that the award necessarily decided that the aircraft could be registered, the District Court put the award, quite unnecessarily, in direct conflict with federal law. This itself was error because if an award is susceptible to different constructions, one of which will make it contrary to federal law and the other not, that construction which will avoid such a conflict should be adopted. *Cf. Anniston Mfg. Co.* v. *Davis*, 301 U. S. 337, 351-52 (1937).

But even if the award had decided that the aircraft could be registered, public policy precludes giving effect to such a determination. See *Kalb* v. *Feuerstein*, 308 U. S. 433 (1940); *Spilker* v. *Hankin*, 188 F. 2d 35, 38 (D. C. Cir. 1951); *Denver Bldg. & Constr. Trades Council* v. *NLRB*, 186 F. 2d 326, 332 (D. C. Cir. 1950), *rev'd on other grounds*, 341 U. S. 675 (1951); *Griffin* v. *State Board of Education*, 296 F. Supp. 1178, 1182 (E. D. Va. 1969); 1B Moore, *Federal Practice* ¶0.405[11] (1965). The *Spilker* and *Denver Bldg.* cases were cited with approval for this proposition by this Court in *Pearlstein* v. *Scudder & German*, 429 F. 2d 1136, 1143 (2d Cir. 1970), *cert. denied*, 401 U. S. 1013 (1971). In *Denver Bldg.* the court stated:

> "The doctrine [of res judicata] is not to be used where the circumstances create a semblance of conditions for its application but to apply it would submerge the plan of Congress for the administration and enforcement of its policy." 186 F. 2d at 332.

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* Even after both sides in the briefs on reargument noted this omission, the District Court failed to deal with the question.

Here the policy of Congress has always been to promote the development of a citizen-owned air fleet. That policy has been implemented by keeping foreign-owned aircraft out of internal air commerce and permitting only citizen-owned aircraft to participate in the revenues of such commerce. The policy would be directly frustrated by treating the award as deciding that the AET aircraft could have been registered and used here and, on that assumption, permitting AET to collect the windfall rents.

Courts will not frustrate congressional policies, or encourage statutory violations, by awarding damages under contracts which require, or form the basis for, conduct which would be illegal. See *Alleghany Corp.* v. *James Foundation*, 214 F. 2d 446, 450 (2d Cir. 1954), *cert. denied*, 348 U. S. 913 (1955); *Kaiser-Frazer Corp.* v. *Otis & Co.*, 195 F. 2d 838, 844 (2d Cir.), *cert. denied*, 344 U. S. 856 (1952); *Bromberg* v. *Moul*, 275 F. 2d 574, 578 (2d Cir. 1960). The purpose of the Agreement was to lease the aircraft to TCA for registration and use in the United States. This would not have been lawful. Rents therefore cannot be awarded as if it would have been lawful.

> "No court should encourage violation of the clear statutory policy by enforcing performance of such a contract —whether by awarding specific performance of the acquisition or *damages for not performing. . . .*" *Alleghany Corp.* v. *James Foundation, supra*, 214 F. 2d at 450. (Emphasis added.)*

In order to understand the full dimensions of this public policy it is necessary to examine the historical bases for the exclusion of foreign aircraft from use in domestic commerce. We do so in some detail because we respectfully submit that this Court should not only reverse the judgment below but should also instruct the District Court to enter summary judgment *in favor of American* on the first three claims.

A. Maritime Cabotage

The word "cabotage" means carriage for remuneration of passengers or goods taken on at one point and discharged at

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* The rule is especially applicable when, as here, AET seeks windfall rents. The Agreement was executory in the sense that the aircraft were never delivered to or used by TCA. This is *not* a case of TCA getting the use of the aircraft and then refusing to pay.

another within the territory of the same country. The concept developed in maritime law and the word itself refers to transportation between two "capes" or points within the same country. As early as the 15th century, England had laws restricting cabotage between English ports to vessels owned by Englishmen. The reason for such a restriction was to build up the English merchant marine by reserving the revenues of cabotage traffic to English-owned vessels. For a discussion of this historical background, see Cooper, *Aviation Cabotage and Territory*, 1952 U. S. Aviation Reports 256-60.

The policy was implemented in later British statutes regulating trade between England and her American colonies, which were considered part of the mother country. These were the famous Navigation Laws, passed by the British Parliament in the decades after the Restoration in 1660.

Winston Churchill described their purpose as follows:

> "The answer devised [by Parliament] was an eminently practical one. British colonial trade must be planned and co-ordinated in London. One of its main objects must be to foster the British Merchant Navy, and to provide a reserve of ships and seamen in the event of war. The foundation of the whole system was the series of enactments known as the Navigation Laws. Colonial trade must travel only in British bottoms, with British crews and to British ports. The colonies were forbidden any outside trade of their own that might hinder the growth of British shipping.*

That the present day maritime and aviation statutes, discussed in more detail below, are the direct descendants of the Navigation Laws is no secret to any informed historian. In describing the Navigation Laws, Samuel Eliot Morison stated:

> "Most nations, including the United States, apply the same principle today; a French ship or airliner can take freight from New York to France, but not from New York to San Francisco."**

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* Churchill, A History of the English-Speaking Peoples, Vol. 3, The Age of Revolution (1957) at 142.

** Morison, The Oxford History of the American People (1965) at 134.

After the American Revolution, as Morison suggests, the United States restricted cabotage trade to citizen-owned vessels. Beginning in 1789, the policy of promoting the development of an American-owned merchant fleet "has found expression in the enactment of a series of statutes . . . which have imposed restrictions of steadily increasing rigor on the transportation of freight in coastwise traffic by vessels not owned by citizens of the United States." *Central Vermont Transportation Co.* v. *Durning*, 294 U. S. 33, 38 (1935).

This Court, as recently as 1970 in *Marine Carriers Corp.* v. *Fowler*, 429 F. 2d 702 (2d Cir. 1970), *cert. denied*, 400 U. S. 1020 (1971), had occasion to apply these stringent congressional policies. The issue was whether an oil tanker formed by joining the stern of one tanker, the TRUSTCO, with the forebody of another, the SANTA HELENA, was entitled to be enrolled for the coastwise trade. Both parts of the vessel had been made in the United States, the reconstruction was done in an American shipyard, and the vessel was owned by a United States citizen. However, the forebody had once been part of a ship owned by foreigners, and the shipping statute is so restrictive that it prohibits enrollment of a vesel for the coastal trade if at any time it has been owned by a foreigner. This Court reversed a District Court's summary judgment holding that the vessel could be enrolled, and remanded the case for a trial to determine whether the reconstructed vessel could be characterized as a reconstructed TRUSTCO, a vessel always owned by U. S. citizens. That was the only way the reconstructed vessel could qualify for enrollment. The Court described the purposes of the maritime statutes regulating admission to the coastal trade:

> "Their aims are to protect the American shipping industry already engaged in the coastwise trade, to provide work for American shipyards, and to improve and enhance the American Merchant Marine." 429 F. 2d at 708.*

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* The Court's opinion cites, among other authorities, *Pennsylvania R. R.* v. *Dillon*, 335 F. 2d 292, 295 n.5 (D. C. Cir.), *cert. denied*, 379 U. S. 945 (1964), where Judge (now Chief Justice) Burger examined in detail the basic policy of this country's series of maritime statutes, and pointed out that "[f]rom the earliest day of the Republic, Congress has been concerned with stimulating and protecting the growth of an American-built and controlled coastwide Merchant Marine."

B. Air Cabotage

With the birth of aviation, the principle that each nation has the sovereign right to reserve air cabotage to aircraft owned by its own citizens was immediately put forward at the first international aviation conference held in Paris in 1910. No agreement was signed as a result of that meeting, but at the next such conference, the Paris Convention of 1919, it was agreed, in Article 16 of the convention as adopted, that each contracting State could establish "restrictions in favour of its national aircraft in connection with carriage of persons and goods for hire between two points on its territory." Later, this principle was repeated in the Convention on International Civil Aviation (the "Chicago Convention"), December 7, 1944, 61 Stat. 1180 (entered into force in the United States April 4, 1947), to which both the United States and Ireland are parties and which remains the controlling international aviation convention. Article 7 of the Chicago Convention, in its cabotage provision, states in pertinent part:

> "Each contracting State shall have the right to refuse permission to the aircraft of other contracting States to take on in its territory passengers, mail and cargo carried for remuneration or hire and destined for another point within its territory."

This principle has become the basis for all national legislation restricting cabotage traffic to domestically-owned aircraft. See 1952 U. S. Aviation Reports, *supra* at 267-72; Sheehan, *Air Cabotage and The Chicago Convention*, 63 Harv. L. Rev. 1157 (1950); Meyer, *Le Cabotage Aerien* (Les Editions Internationales, Paris, 1948).

C. Federal Statutes

The first general federal statute dealing with aviation was the Air Commerce Act of 1926, 44 Stat. 568. Section 6 of the Act adopted the cabotage principle by providing that "no foreign aircraft shall engage in interstate or intrastate air commerce." During the debates prior to passage of the Act, Congressman Lea of California, one of the sponsors, noted that "foreign aircraft are not permitted to register under the provisions of this bill" and that "this bill prevents foreign aircraft from engaging in interstate commerce. This provision follows the rule in reference to water transportation. Only American ships can engage in

the coastal trade of the United States or in interstate commerce." 67 Cong. Rec. 7323 (April 12, 1926). The same point was expressed by Congressman Merritt of Connecticut who stated, "There is another provision of importance, and that is that foreign-owned aircraft shall not engage in interstate commerce in this country. That provision is similar to the provision for coastwise traffic." 67 Cong. Rec. 7316 (April 12, 1926).

Section 6 of the 1926 Act also permitted the Secretary of Commerce to authorize, on a reciprocal basis, "aircraft registered under the laws of [a] foreign nation" to be navigated in the United States but, as stated above, specifically provided that "no foreign aircraft shall engage in interstate or intrastate air commerce." The appendix to the report of the House Committee on Interstate and Foreign Commerce, commenting on the legislation section by section, pointed out the distinction:

> "Under the section the Secretary of Commerce may by regulation exempt . . . foreign civil aircraft if the foreign nation grants a similar exemption in respect of aircraft of the United States. *Unless this exemption were invoked, the requirements of registration and American ownership would exclude foreign craft. . . .*
>
> *"The exemption may not be invoked to permit foreign aircraft to engage in interstate as distinguished from foreign commerce in the United States, and foreign aircraft are entirely barred from such interstate commerce."* Appendix to H. R. Rep. No. 572, 69th Cong., 1st Sess. (March 17, 1926), reprinted in Lee, *Legislative History of the Air Commerce Act of 1926* at 38-39 (Gov't Printing Office 1943). (Emphasis added.)

The anti-cabotage provisions of the 1926 Act were continued without substantive change at the time of the enactment of the next major aviation act, the Civil Aeronautics Act of 1938, 52 Stat. 973, which repealed and replaced many other provisions of the 1926 Act. In 1953, Congress tightened the language of Section 6 to conform to Article 7 of the Chicago Convention. The House Committee Report accompanying the bill explains clearly the historical purpose of the legislation, as well as stating that the amendment was intended "to leave no doubt that the United States will take full advantage of the reservation accorded it by article 7 of that convention."*

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* 1953 U. S. Code Cong. and Admin. News, Vol. 2, at 2227.

Today the provision is found in Section 1108 of the Federal Aviation Act, 49 U. S. C. § 1508, which states in pertinent part,

> "The United States of America is declared to possess and exercise complete and exclusive national sovereignty in the airspace of the United States. . . . *Foreign civil aircraft . . . shall not take on at any point within the United States, persons, property, or mail carried for compensation or hire and destined for another point within the United States. . . .*" (Emphasis added.)

From this historical perspective, it is clear that Congress throughout our aviation history has consistently reserved internal air commerce to U. S.-owned aircraft.* It is important to recognize that the restriction has not been simply to U. S. *citizens*, but to U. S. *aircraft*. While it is true that only U. S. citizens can register aircraft in the United States, it is also true that even U. S. citizens can register only aircraft owned by themselves or other U. S. citizens. It would have been simple enough, if Congress had so intended, to restrict cabotage traffic to U. S. citizens. But Congress intended more. It intended to insure the development of a home-owned air fleet by restricting the vast revenues of U. S. domestic air commerce—by far the largest on earth—to aircraft owned by U. S. citizens. Without such a restriction, many U. S. carriers, especially those with seasonal routes, might find it tempting to use aircraft belonging to foreigners, especially when such aircraft are available, as were the AET aircraft, seasonally and at cheap rents. For economic, regulatory and defense reasons, Congress has never permitted this reliance on foreign aircraft.

D. Registration of Aircraft

Primarily for the purpose of implementing the cabotage rule by distinguishing "foreign" from "domestic" aircraft, the 1919 Paris Convention, as well as the Chicago Convention of 1944, provided that aircraft would be considered to possess the nation-

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* For an extensive discussion of one unsuccessful effort by a foreign carrier to shade the rule, see *Petition of Qantas*, 29 C. A. B. Reports 33 (1959).

ality of the State in which they were registered.* Article 6 of the Paris 1919 Convention; Article 17 of the Chicago Convention. In addition, the Chicago Convention provides in Article 19 that the registration or transfer of registration of aircraft in any contracting State shall be in accordance with the laws and regulations of that State.

As already seen, United States aviation statutes have followed a consistent policy of restricting registration to aircraft wholly-owned by United States citizens. See Section 3(a) of the 1926 Act, 44 Stat. 568, and Section 501 of the Civil Aeronautics Act of 1938, 52 Stat. 1005. The current registration provisions are found in Section 501 of the Federal Aviation Act of 1958, 49 U. S. C. § 1401, which is substantively unchanged from the prior law and which in pertinent part provides as follows:

> "SUBCHAPTER V—NATIONALITY AND OWNERSHIP OF AIRCRAFT
>
> "1401. Registration of aircraft nationality . . .
>
> (a) It shall be unlawful for any person to operate or navigate any aircraft eligible for [U. S.] registration if such aircraft is not registered by its owner as provided in this section. . . .
>
> "Eligibility for registration
>
> (b) An aircraft shall be eligible for registration *if, but only if*—
>
> (1) *It is owned by a citizen of the United States* and it is not registered under the laws of any foreign country. . . ." [**] (Emphasis added.)

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* The implementation of the cabotage principle is repeatedly stated as the main reason for registration provisions, although registration is convenient for other reasons as well. See Kingsley, *Nationality of Aircraft*, 3 J. Air. L. 50 at 51 (1932); Lupton, *Civil Aviation Law* 11-12 (Callaghan & Co. 1935); Meyer, *Le Cabotage Aerien* (Les Editions Internationales, Paris, 1948).

** The term "citizen" of the United States is defined in Section 101(13) of the Act, 49 U. S. C. § 1301(13), as (a) an individual citizen, or (b) a partnership of which each member is a citizen, or (c) a corporation, created under the laws of the United States or one of its states or territories, of which the president and at least two-thirds of the directors and other managing officers are citizens and of which at least 75 percent of the voting interest is owned or controlled by United States citizens.

The applicable air regulations are found in volume 14 of the Code of Federal Regulations, Part 47, which deals with registration. Section 47.43 pertinently provides:

> *"Invalid Registration.*
> "(a) The registration of an aircraft is invalid if, at the time it is made—
>
> (1) The aircraft is registered in a foreign country;
>
> (2) The applicant is not the owner;
>
> (3) The applicant is not a citizen of the United States; or
>
> (4) The applicant is a citizen of the United States, but his interest in the aircraft was created by a transaction that was not entered into in good faith and was made to avoid (with or without the owner's knowledge) compliance with section 501 of the Federal Aviation Act of 1958 (49 U. S. C. § 1401), that prevents registration of an aircraft owned by a person who is not a citizen of the United States."

This combination of statutes and regulations bars both a foreigner and a U. S. citizen from using a foreign-owned aircraft on U. S. cabotage routes. The registration law acts as a statutory border guard to keep foreign-owned aircraft off such routes. There have been no exceptions to this prohibition throughout the history of United States aviation.*

E. Ownership and Conditional Sales

As early as 1939 the Civil Aeronautics Authority (the predecessor of the FAA) was called upon to interpret the meaning of

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* A limited use of foreign aircraft in this country for commercial but *non-cabotage* purposes, such as crop dusting with Canadian aircraft, has been permitted under the statute. A long discussion of the distinction appears in 1953 U. S. Code Cong. and Admin. News, Vol. 2, at 2225-2236, and the distinction itself underscores the cabotage prohibition.

"ownership" for registration purposes. In *Matter of O'Connor*, 1 C. A. A. Reports 5 (1939), the purchaser of a Piper aircraft under a conditional sales contract with the manufacturer asked the CAA to rule whether a conditional vendee could be considered to have ownership for purposes of registration. In considering the question, the CAA noted that:

> "Of late years . . . the view has begun to receive wide acceptance that the purchaser who has been put into possession of chattels pursuant to a conditional sales contract is the owner of a beneficial title and that the seller has retained his legal title merely as security that the agreed selling price will be paid as promised. . . ." *Id.* at 6.

Thus, the CAA concluded:

> "We are of the opinion that a purchaser, who has complete control over the aircraft to do with it as he will even as against the seller as long as the payments are duly made, is a proper person to be considered 'an owner' for the purpose of registration under Section 501 of the Civil Aeronautics Act of 1938. The obligations imposed by the Civil Air Regulations upon the registered owner obviously belong to the owner who is in actual possession and control of the aircraft. . . . [I]n *this instance both the applicant and Wiggins Airways, Inc., appear to be citizens of the United States, and there is no evidence of any attempt to use the conditional sale as a device for securing American registration for an aircraft the beneficial ownership of which is vested in a non-citizen.*" *Ibid.* (Emphasis added.)

One year later, following the approach in *O'Connor*, the CAA added a new Section 0.13 to the Regulations:

> "§ 01.13 *Invalidation.* Any registration of an aircraft by the Authority shall be null and void if at the time of registration (a) the aircraft was registered under the laws of any foreign country; or (b) the person registered as owner was not the true and lawful owner of

> the aircraft; or (c) the person registered as owner was not a citizen of the United States as defined in section 1(13) of the Civil Aeronautics Act of 1938, *or the interest of such person in the aircraft was created by any transaction not entered into in good faith but for the purpose of avoiding, with or without the knowledge of the registered owner, the provision of the Civil Aeronautics Act of 1938, prohibiting the registration of an aircraft in the name of a person not a citizen of the United States.*" 5 Fed. Reg. 1758-59 (May 16, 1940). (Emphasis added.)

This Regulation, with only slight change, has remained in effect and today is found in Section 47.43.

Later, in 1955, the CAA issued an interpretive regulation defining "owner". Still following the approach taken in *O'Connor*, it added the following to what was then Part 501 of the Civil Air Regulations:

> "The purchaser of aircraft under a contract of conditional sale is the owner for the purpose of registration and shall submit the contract of conditional sale as proof of ownership when applying for registration. . . . Where an equitable interest under a contract of conditional sale has been assigned, the assignee is the owner for the purpose of registration and shall submit the original contract of conditional sale . . . and an assignment from the original conditional purchaser to the applicant for registration. . . . [T]here shall also be affixed the signature of the holder (conditional seller or his assignee) of the contract of conditional sale to show assent to the assignment of the equitable interest." Civ. Air Regs. § 501.4(b)(2)(ii), 20 Fed. Reg. 3299 (May 14, 1955).

In footnote 6 to the Regulation the CAA adopted the definition of "conditional sale" contained in Section 1(17) of the Civil Aeronautics Act of 1938. That definition was virtually identical to the definition of "conditional sale" provided by the Uniform

Conditional Sales Act, 2 U. L. A. § 1 (1922).*

The definition of owner was shortened in 1964 and again in 1966 but without substantive change, 29 Fed. Reg. 6486 (May 19, 1964); 31 Fed. Reg. 4495 (May 17, 1966), and today provides:

> "In this part, 'owner' includes a buyer in possession, a bailee, or a lessee of an aircraft under a contract of conditional sale, and the assignee of that person." 14 C. F. R. § 47.5(c).

This section, taken together with its companion provision § 47.43 quoted *supra* at 36, presents the parameters of the "ownership" requirement for registration under the Federal Aviation Act.

When viewed in the light of their history, the import of these provisions is clear. For an aircraft to be registrable in the United States, it must be beneficially owned by an American citizen—no more, no less. When a conditional sale is involved, an Ameri-

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* The definition provided by footnote 6 read as follows:

> "As defined by Section 1(17) of the Civil Aeronautics Act of 1938, as amended, '"Conditional sale" means (a) any contract for the sale of an aircraft, aircraft engine, propeller, appliance, or spare part under which possession is delivered to the buyer and the property is to vest in the buyer at a subsequent time, upon the payment of part or all of the price, or upon the performance of any other condition or the happening of any contingency; or (b) any contract for the bailment or leasing of an aircraft, aircraft engine, propeller, appliance, or spare part, by which the bailee or lessee contracts to pay as compensation a sum substantially equivalent to the value thereof, and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming, the owner thereof upon full compliance with the terms of the contract. The buyer, bailee, or lessee shall be deemed to be the person by whom any such contract is made or given.'" 20 Fed. Reg. 3299 (May 14, 1955).

can citizen must, as a matter of economic reality, be in the process of purchasing the aircraft by time payments. If the transaction is one where a lessee is not actually purchasing the aircraft by time payments, but is simply renting it, then the transaction does not qualify as a conditional sale, the lessee is not the owner, and the aircraft cannot be registered.

When these principles are applied to the Agreement at issue in this case, there is no question that the registration of the AET aircraft was legally impossible. If the arbitrators did indeed find, as the District Court concluded, that these aircraft were entitled to be registered in the United States, that decision is in the teeth of contrary federal policy and no court can give effect to that determination.

F. The AET-TCA Agreement

It is clear beyond dispute that TCA was not the owner of these aircraft, and that it was not purchasing them under a contract of conditional sale.

1. The aircraft were to be leased to TCA only for specified periods during the wintertime. They were to be returned to AET each spring, and permanently at the end of the Agreement.

2. TCA was not acquiring any equity in the aircraft by its rental payments. The payments were pure rent.

3. The only faint nod in the direction of a possible *future* sale was the insertion in each lease of an option to purchase. But the option price at the outset was to be 115 percent of a current Boeing quotation for a then new aircraft. At the very beginning of the first lease for the first plane the price was thus unrealistically high, and as the aircraft grew older each year the option price would increase, since it would always be 115 percent of a Boeing quote for a *new* aircraft. It was like an option to buy a particular used car, which every year was getting older, at 115 percent of the cost of next year's new model. But regardless of the economic absurdity of the option price, TCA would not become the owner unless and until it exercised the option and purchased or began to purchase the aircraft. Until that time it could

not register the aircraft in the United States because it was not the owner.

4. The option was put in the lease form (and the high option price set to be sure that it would never be exercised) because it was hoped that by this subterfuge the registration application might be slipped by and approved by the non-lawyer clerks at the Oklahoma City Registry Office who would not understand the transaction.*

The indisputable fact is that no one who understood the transaction could possibly conclude that TCA was the owner of the aircraft and entitled to register it in the United States. The registration would have been invalid from the outset under Section 47.43 of the Regulations even if the registration had been issued without challenge. These are the blunt facts of the matter. For this reason American is entitled to the declaratory judgment sought in this action. We submit that, in view of the controlling facts relating to AET's ownership, which cannot be genuinely challenged, and the plain, consistent, and well documented statutory history, the District Court's opinion should not only be reversed, but the case should be remanded with instructions to enter summary judgment on the first three claims in favor of American and against AET. What is the point of continuing with this litigation if American is right on the law?

III.

The District Court erred in granting summary judgment on the fourth claim by resolving material disputed facts against American and by ignoring American's allegation that the TCA defaults did not proximately cause AET damage.

The District Court interpreted the fourth claim as limited to "the argument that [AET's] termination of the 1968 agreement

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* If, simply by the sleight of hand of putting an option in a lease, a U. S. lessee could register and operate a foreign-owned aircraft, the whole scheme of Congress would be frustrated.

was 'improper and unconscionable'." (A 265) Then, equating this contention with TCA's defense in the arbitration that AET "terminated the Agreement in bad faith," the District Court held that the arbitrators had decided that issue when they found "that AET 'followed proper procedure in effectuation of cancellation'." (A 265)

First, even if the arbitrators decided that AET did not terminate in bad faith, that does not mean they decided that AET had a legal right to terminate. A party may act in "good faith" but still lack the legal right to take the action he takes. Where a large, long-term contract is involved, a default may be so *de minimis* and so quickly corrected—as we believe was true here —as not to invest the other party with the legal right to terminate. This can be true notwithstanding that the terminating party may erroneously believe in "good faith" that he has a right to terminate.

Second, AET's *substantive right* to terminate, as distinguished from the *procedure* it followed, was a matter of AET's Section 9.2 remedies, and this subject was specifically excluded from the scope of arbitration. AET itself made this distinction as recently as December 1973, when in the State confirmation proceeding it pointed out to the Appellate Division that (A 288),

> *"The question of 'remedy' would be whether respondent [AET] had the right to terminate under Section 9.2 of the Agreement,* not whether it followed correct procedures in exercising this right. *Respondent did not submit this question to arbitration,* since its remedies are fixed by the Agreement and follow automatically upon an event of default. *The relief requested was a declaration that* in exercising this contractual right of termination, *respondent followed the procedures* prescribed in the Agreement." (Emphasis added.)

Thus AET's own brief in the State court shows the error in the conclusion reached by the District Court when it dismissed the fourth claim.

The District Court erred in still another respect in dealing with the fourth claim. It ignored the fact that the claim is not limited to the allegation that AET's termination was "improper". The basic thrust of the fourth claim is that

> "Any loss of rentals or other payments or damages suffered by AET were self-inflicted, and resulted from its improper termination and not from any default by TCA."

In other words, the amended complaint alleges that AET's purported damages were *not caused by TCA's defaults* but by AET's own wilful insistence on not continuing the Agreement. Clearly this causation claim cannot be dismissed without a trial.

The District Court chose to ignore the fact that TCA immediately corrected the two alleged *de minimis* defaults upon which AET based its termination. As a consequence, AET could not possibly have suffered any damages from those defaults. Further, even if TCA had failed up until September 2, 1970 to exercise best efforts with respect to registration, AET had suffered no damages as a consequence of this failure at the time it terminated.

An injured party is not entitled to damages for losses that he could have avoided by his own efforts. See, *e.g.*, *Warren* v. *Stoddart*, 105 U. S. 224, 229-30 (1881). This "duty to mitigate" often requires the injured party to deal further with the breaching party, even though that party may have been in default. See, *e.g.*, *Warren* v. *Stoddart*, *supra* at 230; *Stanspec Corp.* v. *Jelco, Inc.*, 464 F. 2d 1184, 1187 (10th Cir. 1972); *United States Navigation Co.* v. *Black Diamond Lines, Inc.*, 124 F. 2d 508, 511 (2d Cir.), *cert. denied*, 315 U. S. 816 (1942); *Lawrence* v. *Porter*, 63 Fed. 62, 66-67 (6th Cir. 1894); *Parsons* v. *Sutton*, 66 N. Y. 92, 98-99 (1876).

If AET had gone forward with the Agreement in September 1970 and if (as it claims) the aircraft could have been lawfully registered, AET need not have suffered any damage from the defaults found by the arbitrators. After AET terminated the Agreement, there remained a period of more than two months before the first aircraft was scheduled for delivery and before

the application to register could have been made. There was ample time to clear up the registration point if AET had not adamantly insisted on not clearing it up. (AET, for example, could have easily accepted American's invitation to confer with the FAA or could have responded to the FAA when, before its opinion was issued, the FAA itself solicited AET's views on the registration question.) By failing to mitigate its damages, AET itself caused any damages it may thereafter have suffered, and it is therefore not entitled to damages from TCA or American.

This is the basic causation argument of the fourth claim, and it was improper for the District Court to dismiss it without a trial.

AET's only defense to the causation argument is its contention that it had a contract right to terminate on September 2, and was not obligated to go forward thereafter. Even if AET did have a right to terminate (which American denies), its obligation to proceed thereafter and to mitigate damages is still an unresolved issue to be determined on trial. Moreover, if AET is in fact asserting that it has the right to collect $13 million in windfall damages under the Agreement even though TCA's defaults were immediately corrected and did *not* cause its injury, and even though AET was the party which terminated and insisted on keeping the Agreement terminated, nothing establishes more clearly that the damage provisions of the Agreement are unenforceably penal.

IV.

The District Cou erred in granting summary judgment on the fifth claim by resolving material disputed facts against American, by misinterpreting the Agreement, and by ruling that a court could award penal damages in this action.

The District Court dismissed the fifth claim, which alleged that the remedies in Section 9.2 of the Agreement are punitive,

on the ground that TCA warranted that they were not. This is patent error.

First, if the damage section of the Agreement is punitive, as American contends, it cannot be enforced by the courts—warranty or no warranty. Under controlling New York law, punitive damages are judicially unenforceable. This is true regardless of whether the parties have agreed to them in a contract. Indeed, the rule precluding enforcement assumes that such damages have been agreed to in the contract. It adds nothing that they were or were not warranted to be legal, since neither a contractual warranty nor an agreed-upon damage provision can make legal what is illegal. Thus, a defense of illegality cannot be contracted away in advance by private parties, as the District Court in effect held, for if that were so, courts would be put in the untenable position of enforcing illegal agreements. See *Brick* v. *Campbell*, 122 N. Y. 337, 346-47 (1890); *Levin* v. *Levin*, 253 App. Div. 758, 300 N. Y. Supp. 1042 (2d Dep't 1937); 17 Am. Jur. 2d, *Contracts* § 232, at 613 (1964).*

Second, the District Court erroneously construed Section 11.2 and Section 11.3 of the Agreement, since neither constitutes a warranty by TCA that the damage provision of Section 9.2 was legal. The language of Section 11.2 quoted by the Court relates only to an alleged warranty "with respect to any such *lease*." (Emphasis added.) (A 25) The punitive damages at issue here do not arise under the leases but under the Agreement itself. Similarly, the alleged warranty under Section 11.3 includes the introductory words (omitted from the language quoted by the District Court), "There is to its [TCA's] knowledge no law. . . ." (A 25) The alleged warranty under Section 11.3 is therefore not absolute, and there is no factual proof on this record by which

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* Assume, for example, a loan agreement which calls for a usurious rate of interest but in which the borrower warrants that the interest rate is legal. Under the District Court's rationale, the borrower could not challenge the interest rate as illegal and the court would have to enforce the loan agreement and the usurious rate. This is incorrect.

the District Court could properly assume TCA's knowledge, when the Agreement was executed in 1968, as to the circumstances in which these punitive damages would later be sought. Even if not inapplicable on its face, the warranty language on which the District Court relies raises mixed questions of fact and law which cannot be resolved on a motion for summary judgment.

Third, the District Court completely overlooked Section 13.8 of the Agreement (A 28). That Section provides that any "provision . . . prohibited by or unlawful or unenforceable under any applicable law of any jurisdiction shall as to such jurisdiction be ineffective. . . ." Thus, the Agreement by its own terms invalidates AET's remedies if they are unenforceable under New York law, or under any other law. It removes such remedies—if unlawful—from the scope of any alleged warranty and makes it possible for American to raise illegality as a defense even if, as the District Court mistakenly ruled, the warranty would otherwise apply. Quite apart from all the other arguments stated, Section 13.8 alone demolishes the District Court's rationale.

Under the law of New York, which applies here in determining whether the damages are penal in nature (A 28),

> "The tendency of the courts in doubtful cases is to favor the construction which makes the sum payable for breach of contract a penalty rather than liquidated damages, even where the parties have styled it liquidated damages rather than a penalty. The general rule of construction is 'that where a contract contains a number of covenants of different degrees of importance and the loss resulting from the breach of some of them will be clearly disproportionate to the sum sought to be fixed as liquidated damages, especially where the loss in some cases is readily ascertainable, the sum so fixed will be treated as a penalty. The strength of the chain is that of its weakest link.'" *City of New York* v. *Brooklyn & Manhattan Ferry Co.*, 238 N. Y. 52, 56, 143 N. E. 788, 790 (1923).

This is not even a "doubtful case" because TCA's *de minimis* defaults did not cause AET *any* damages. AET "set up" its entire damage situation by terminating, by refusing to permit TCA to

correct its alleged "defaults", and by rejecting American's invitation to confer with the FAA. This is the posture in which AET now seeks huge windfall damages. Under the language of the Agreement (A 21-24), AET is entitled to full rental payments without performing, is relieved of any obligation of reletting or using the aircraft, is permitted under the Agreement to collect fifty percent of the rents even when using the aircraft at a profit, and is given various other options and alternatives. Such "disproportionate" and "oppressive" damages—when measured against the circumstances here—are punitive and cannot be enforced. See, *e.g.*, *884 West End Ave. Corp.* v. *Pearlman*, 201 App. Div. 12, 193 N. Y. S. 670 (1st Dep't), *aff'd*, 234 N. Y. 589, 138 N. E. 458 (1922). At most AET is entitled to the damages proximately caused by the alleged defaults of TCA, and at trial it can be proved there were no such damages.

For all these reasons, it was error to dismiss the fifth claim.

V.

The District Court erred and abused its discretion by alternatively declining to entertain the declaratory judgment action.

In the final paragraphs of its opinion, the District Court concluded that "even if TCA had some claim on the merits" (A 268), the court in its discretion would decline jurisdiction of the action. The District Court apparently reached this conclusion because it believed that the action was "plainly a device and stratagem of TCA to stall or delay the pursuit by AET of its remedies for the established defaults of TCA." (A 267)

The action was commenced immediately after receipt of the aribitration award. It does no more than seek a prompt adjudication of the remedies questions (some of which involve important issues of federal law and national aviation policy) excluded from the arbitration. It is unclear how the action can be characterized as a device "to stall or delay".

In fact, it was not until July 1973, almost six months after this action was started and three months after AET's motion to dismiss was argued, that AET filed a separate action, 73 Civ. 2933 (the "rent action"), asserting its remedies claims (primarily rents) under the Agreement. Yet the District Court defers to that action as the place where "any further defenses of TCA surviving the arbitration . . . can be better determined." (A 267-68)

Since the case at bar will serve "a useful purpose in clarifying and settling the legal relations in issue" and since "it will terminate and afford relief from the . . . controversy giving rise to the proceeding," this action should be entertained "and the failure to do so is error." *Broadview Chemical Corp.* v. *Loctite Corp.*, 417 F. 2d 998, 1001 (2d Cir.), *cert. denied*, 397 U. S. 1064 (1969). Thus, it was an abuse of discretion for the Court to have dismissed the suit.

Furthermore, it is essential on this appeal that the substantive legal errors in the District Court's opinion be reviewed and, we submit, overturned. If, as American contends, there is no ground for genuine dispute as to the ownership of the aircraft, and no doubt from the long, consistent statutory history that they could not have been registered and used by TCA in the United States, then this case should be brought to an end by remanding it to the District Court with instructions to enter summary judgment in favor of American on the first three claims.

Alternatively, this Court should deal with the issues presented on this appeal, and even if it does not instruct that summary judgment be entered for American on the first three claims, the summary judgment granted below should be reversed. Otherwise, the errors will be repeated and compounded in the pending rent action in the District Court, also assigned to Judge Wyatt. He has obviously made up his mind on a number of decisive points, and it is an open secret that AET, on the basis of the opinion here appealed from, is planning to move for summary judgment in the rent action. Another appeal in that action, repeating the same questions raised on this appeal, will be neces-

sary if the District Court's errors are not corrected now. This wasteful duplication of judicial and legal effort should and can be avoided. We therefore submit that at a minimum the judgment appealed from should be reversed, and the case remanded for consolidation with the rent action. One trial can then be held on the merits. This is the most sensible, orderly and efficient judicial procedure if this Court does not order summary judgment for American on the first three claims.

CONCLUSION

For the reasons stated above, plaintiff-appellant American Airlines, Inc. respectfully requests that this Court reverse the District Court's judgment and remand the case with instructions to enter summary judgment for American on the first three claims. In the alternative, American requests that on remand the case be ordered consolidated for trial with the rent action.

Dated: New York, New York
June 12, 1974

Respectfully submitted,

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Statutory Addendum

Section 101(103) of the Federal Aviation Act of 1958, 49 U. S. C. § 1301(13):

> "Citizen of the United States" means (a) an individual who is a citizen of the United States or one of its possessions, or (b) a partnership of which each member is such an individual, or (c) a corporation or association created or organized under the laws of the United States or of any State, Territory, or possession of the United States, of which the president and two-thirds or more of the board of directors and other managing officers thereof are such individuals and in which at least 75 per centum of the voting interest is owned or controlled by persons who are citizens of the United States or of one of its possessions.

Section 101(16) of the Federal Aviation Act of 1958, 49 U. S. C. § 1301(16):

> "Conditional sale" means (a) any contract for the sale of an aircraft, aircraft engine, propeller, appliance, or spare part under which possession is delivered to the buyer and the property is to vest in the buyer at a subsequent time, upon the payment of part or all of the price, or upon the performance of any other condition or the happening of any contingency; or (b) any contract for the bailment or leasing of an aircraft, aircraft engine, propeller, appliance, or spare part, by which the bailee or lessee contracts to pay as compensation a sum substantially equivalent to the value thereof, and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming, the owner thereof upon full compliance with the terms of the contract. The buyer, bailee, or lessee shall be deemed to be the person by whom any such contract is made or given.

Section 501 of the Federal Aviation Act of 1958, 49 U. S. C. § 1401:

> *Registration of aircraft nationality—necessity; aircraft of national-defense forces; transfer of ownership.*

(a) It shall be unlawful for any person to operate or navigate any aircraft eligible for registration if such aircraft is not registered by its owner as provided in this section, or (except as provided in section 1508 of this title) to operate or navigate within the United States any aircraft not eligible for registration: *Provided*, That aircraft of the national-defense forces of the United States may be operated and navigated without being so registered if such aircraft are identified, by the agency having jurisdiction over them, in a manner satisfactory to the Secretary of Transportation. The Secretary of Transportation may, by regulation, permit the operation and navigation of aircraft without registration by the owner for such reasonable periods after transfer of ownership thereof as the Secretary may prescribe.

Eligibility for registration.

(b) An aircraft shall be eligible for registration if, but only if—

(1) It is owned by a citizen of the United States and it is not registered under the laws of any foreign country; or

(2) It is an aircraft of the Federal Government, or of a State, Territory, or possession of the United States, or the District of Columbia, or of a political subdivision thereof.

Issuance of certificate.

(c) Upon request of the owner of any aircraft eligible for registration, such aircraft shall be registered by the Secretary of Transportation and the Secretary shall issue to the owner thereof a certificate of registration.

Applications.

(d) Applications for such certificates shall be in such form, be filed in such manner, and contain such information as the Secretary of Transportation may require.

Suspension or revocation.

(e) Any such certificate may be suspended or revoked by the Secretary of Transportation for any cause which renders the aircraft ineligible for registration.

Effect of registration.

(f) Such certificate shall be conclusive evidence of nationality for international purposes, but not in any proceeding under the laws of the United States. Registration shall not be evidence of ownership of aircraft in any proceeding in which such ownership by a particular person is, or may be, in issue.

Section 1108 of the Federal Aviation Act of 1958, 49 U. S. C. § 1508:

Declaration of national sovereignty in air space; operation of foreign aircraft.

(a) The United States of America is declared to possess and exercise complete and exclusive national sovereignty in the airspace of the United States, including the airspace above all inland waters and the airspace above those portions of the adjacent marginal high seas, bays, and lakes, over which by international law or treaty or convention the United States exercises national jurisdiction. Aircraft of the armed forces of any foreign nation shall not be navigated in the United States, including the Canal Zone, except in accordance with an authorization granted by the Secretary of State.

(b) Foreign aircraft, which are not a part of the armed forces of a foreign nation, may be navigated in the United States by airmen holding certificates or licenses issued or rendered valid by the United States or by the nation in which the aircraft is registered if such foreign nation grants a similar privilege with respect to aircraft of the United States and only if such navigation is authorized by permit, order, or regulation issued by the Board hereunder, and in accordance with the terms, conditions, and limitations thereof. The Board shall issue such permits, orders, or regulations to such extent only as it shall find such action to be in the interest of the public: *Provided, however,* That in exercising its powers hereunder, the Board shall do so consistently with any treaty, convention, or agreement which may be in force between the United States and any foreign country or countries. Foreign civil aircraft permitted to navigate in

the United States under this subsection may be authorized by the Board to engage in air commerce within the United States except that they shall not take on at any point within the United States, persons, property, or mail carried for compensation or hire and destined for another point within the United States. Nothing contained in this subsection shall be deemed to limit, modify, or amend section 1372 of this title, but any foreign air carrier holding a permit under said section shall not be required to obtain additional authorization under this subsection with respect to any operation authorized by said permit.

Section 47.5(c) of the Federal Aviation Regulations, 14 C. F. R. § 47.5(c):

> In this part, "owner" includes a buyer in possession, a bailee, or a lessee of an aircraft under a contract of conditional sale, and the assignee of that person.

Section 47.43 of the Federal Aviation Regulations, 14 C. F. R. § 47.43:

> (a) The registration of an aircraft is invalid if, at the time it is made—
>
> (1) The aircraft is registered in a foreign country;
>
> (2) The applicant is not the owner;
>
> (3) The applicant is not a citizen of the United States; or
>
> (4) The applicant is a citizen of the United States, but his interest in the aircraft was created by a transaction that was not entered into in good faith and was made to avoid (with or without the owner's knowledge) compliance with section 501 of the Federal Aviation Act of 1958 (49 U. S. C. 1401), that prevents registration of an aircraft owned by a person who is not a citizen of the United States.
>
> (b) If the registration of an aircraft is invalid under paragraph (a) of this section, the holder of the invalid Certificate of Aircraft Registration shall return it as soon as possible to the FAA Aircraft Registry.

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